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World economic situation and prospects as of mid-2014**

Summary

As projected in *World Economic Situation and Prospects 2014*, the world economy is expected to strengthen in 2014-2015, although the most recent updated global growth trajectory is slightly lower than previously forecast. Recovery in the developed economies will continue, but the growth prospects for the developing economies and the economies in transition have been revised downward, largely because of worsened economic and/or political conditions in a number of countries in the latter two groups.

The present report identifies a number of risks and uncertainties for the world economy, including international spillovers from the future unwinding of monetary easing by major developed economies; vulnerabilities of emerging economies on both the external and domestic front; remaining fragilities in the euro area; unsustainable public finance in the longer term for many developed countries; and risks associated with geopolitical tensions.

After assessing policy challenges facing different groups of economies in the monetary and fiscal areas, the most recent developments in trade policies and policies aimed at strengthening employment growth, the present report calls for the strengthening of international policy coordination to support a robust recovery of output and jobs, cooperation in regard to international financial reforms and the provision of sufficient development financing resources to the least developed countries.

* E/2014/1/Rev.1, annex II.

** The present document updates *World Economic Situation and Prospects 2014* (United Nations publication, Sales No. E.14.II.C.2), released in January 2014.

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Global macroeconomic trends

Global growth prospects

1. The world economy is expected to accelerate in 2014 and 2015, with updated growth rates of, respectively, 2.8 per cent and 3.2 per cent (see table), which are slightly lower than the forecast made in *World Economic Situation and Prospects 2014*,[1] released in January 2014.

2. A downward revision has been made mainly in the growth projections for developing economies and the economies in transition, as the situation in a number of countries in these two groups has somewhat deteriorated. With projected growth rates of 4.7 per cent and 5.1 per cent for 2014 and 2015, respectively, developing countries as a whole will continue to contribute a large proportion of global growth. However, this growth trajectory is lower by two percentage points than that registered by the developing countries for a number of years prior to the global financial crisis. The downward revision in growth for the economies in transition is even more pronounced. As demonstrated in the two recent episodes of financial turbulence in mid-2013 and early 2014, a number of developing countries are vulnerable not only to the international spillovers from the adjustments made to monetary policies by major developed countries but also to quite a few country-specific challenges, including structural imbalances, infrastructural bottlenecks, increased financial risks, incoherent macroeconomic management and political tensions.

3. Growth in the developed economies is projected to be 2.0 per cent and 2.4 per cent for 2014 and 2015, respectively, about one percentage point higher than in the previous two years. For the first time since 2011, all major developed economies in North America, Europe and developed Asia are aligned together on the same upward growth trajectory, forming, hopefully, a virtual cycle to reinforce their recovery. Nevertheless, after five years of being mired in the aftermath of the financial crisis, these projected growth rates are insufficient to recuperate the output and job losses in most of these economies. They are still confronting a number of challenges, including the remaining fragilities in the euro area, the elevated unemployment rates in some of them and unsustainable public finances in the longer term.

[1] United Nations publication, Sales No. E.14.II.C.2.

Growth of world output, 2012-2015

(Annual percentage change)

					Change from January 2014 forecast	
	2012	2013[a]	2014[b]	2015[b]	2014	2015
World	2.3	2.2	2.8	3.2	-0.2	-0.1
Developed economies	1.3	1.1	2.0	2.4	0.1	0.0
United States of America	2.8	1.9	2.5	3.2	0.0	0.0
Japan	1.4	1.5	1.4	0.9	-0.1	-0.3
European Union	-0.4	0.1	1.6	1.9	0.2	0.0
15 European Union members	-0.5	0.0	1.5	1.8	0.1	0.0
New European Union members	0.6	1.1	2.4	2.9	0.3	0.2
Euro area	-0.7	-0.4	1.2	1.6	0.1	0.0
Other European	1.8	1.4	2.3	2.3	-0.3	-0.6
Other developed countries	2.5	2.2	2.1	2.6	-0.5	-0.3
Economies in transition	3.2	2.0	1.6	2.3	-1.7	-1.7
South-Eastern Europe	-0.9	1.9	2.0	3.1	-0.6	0.0
Commonwealth of Independent States and Georgia	3.4	2.0	1.6	2.3	-1.8	-1.8
Russian Federation	3.4	1.3	1.0	1.5	-1.9	-2.1
Developing economies	4.7	4.6	4.7	5.1	-0.4	-0.2
Africa	5.7	3.7	4.2	5.1	-0.5	0.1
North Africa	7.2	2.1	2.4	4.2	-0.9	-0.1
East Africa	5.8	6.0	6.5	6.6	0.1	0.2
Central Africa	5.8	3.2	4.5	4.1	-0.3	0.0
West Africa	6.6	6.5	7.0	7.1	0.1	0.3
Southern Africa	3.5	3.1	3.6	4.4	-0.6	0.0
East and South Asia	5.4	5.6	5.7	5.8	-0.1	-0.2
East Asia	5.9	6.0	6.0	6.0	-0.1	-0.1
China	7.7	7.7	7.3	7.1	-0.2	-0.2
South Asia	3.4	3.9	4.6	5.1	0.0	0.0
India	4.7	4.8	5.0	5.5	-0.3	-0.2
Western Asia	3.8	3.8	3.6	4.4	-0.8	0.4
Latin America and the Caribbean	3.0	2.7	2.6	3.4	-1.0	-0.7
South America	2.5	3.2	2.1	3.0	-1.3	-1.1
Brazil	0.9	2.3	1.7	2.8	-1.3	-1.4
Mexico and Central America	4.0	1.6	3.3	4.2	-0.7	0.0
Caribbean	2.8	2.9	3.6	3.7	0.3	-0.1
Least developed countries	4.8	5.3	5.6	5.9	-0.1	0.2
Memorandum items						
World trade[c]	2.5	2.5	4.1	5.1	-0.6	-0.1
World output growth with purchasing-power-parity-based weights	3.1	2.9	3.4	3.8	-0.2	-0.2

Source: Department of Economic and Social Affairs.

[a] Partly estimated.

[b] Forecast, based in part on Project LINK.

[c] Includes goods and services.

Employment trends

4. Globally, employment is estimated to have grown by 1.4 per cent in 2013,[2] a similar pace as in 2012 but stubbornly slower than the rate of 1.7 per cent in pre-crisis years. As a result, the global jobs gap (comparing the current number of existing jobs with the number of jobs that would exist considering the pre-crisis trend) widened further, to 62 million in 2013. The global unemployment rate also remained unchanged at 6 per cent in 2013.[2] Long-term unemployment has been rising in developed countries, which could lead to higher levels of structural unemployment. Across developing countries, a main challenge remains the level of informal employment which, on average, has reached between 40 and 50 per cent in Africa, Asia and Latin America and the Caribbean. Global employment is expected to continue growing at a slow pace.

Inflation outlook

5. Global average inflation is projected to increase mildly from 2.4 per cent in 2013 to 2.7 per cent in 2014, the third-lowest level since 2000. However, the trends at the subregional level vary. While average inflation for developed economies is expected to increase from 1.2 per cent in 2013 to 1.5 per cent in 2014 due to higher inflation in Japan, inflation in the European Union will actually decrease from 1.5 per cent to 1.1 per cent because of the sizeable output gap, the weakness of the recovery and the strength of regional currencies, with a fall into deflation constituting a downside risk for some European countries. For the economies in transition, average inflation for the Commonwealth of Independent States will increase and fully compensate for the almost 2 percentage point drop in inflation for the South-Eastern European countries. Average inflation in the developing economies will remain relatively stable. While inflation for Africa and Western Asia will decline slightly, a more pronounced decrease is forecast for South Asia, mainly due to falling inflation in India and the Islamic Republic of Iran. By contrast, East Asia will register a slight increase in inflation. In Latin America and the Caribbean, inflation rates are fairly stable, with the notable exception of Argentina and the Bolivarian Republic of Venezuela.

Commodity prices

6. International commodity prices will remain at high levels by historical standards but will face downward pressure and great variation across commodities. The price of Brent crude oil is expected to fall from the average $108 per barrel in 2013 to an average of $105 per barrel in 2014. If the recovery of global demand is slower than expected, oil prices could drift down further than anticipated. If further disruptions occur on the supply side in Libya, Iraq, Nigeria or other oil-exporting countries, oil prices may go above the projected level. Prices for agricultural products are also expected to decline in 2014 despite the strengthening global demand, as the relatively high prices for key staples in recent years have led to increased planting. In addition, the buoyant harvest in 2013 led to a noticeable improvement in global stocks. Even though the geopolitical tensions around Ukraine and the dry weather in some agricultural producing countries, including the United States of America and Brazil, raised concerns regarding agricultural food prices, the

[2] International Labour Organization, *Global Employment Trends 2014: Risks of a Jobless Recovery?* (Geneva, International Labour Office, 2014).

favourable stock situation and the expected abundant harvest in 2014, in particular for grains, are likely to keep prices below 2013 levels. Prices for soybeans are also projected to decline, as record high global production is anticipated in 2014. After a significant decline in 2013, prices for minerals and metals are expected to stabilize in 2014, before slightly increasing in 2015 owing to strengthening global demand and tightening supply in some markets.

International trade flows

7. World trade growth was flat in the first quarter of 2014. However, some gradual improvement is expected over the course of the year as import demand in major developed countries continues to gradually increase. Real exports are forecast to grow by 4.1 per cent in 2014, almost twice as fast as in 2013 but still below the pre-crisis trend of double the global output growth. Further improvement is expected to continue into 2015, with export growth rising to 5.1 per cent. Forecasts for both 2014 and 2015 have been revised down slightly, owing to downward revisions in output growth rates for Japan and a number of developing regions. Recent macroeconomic and financial instabilities in a number of developing countries, as well as concerns about slowing growth in large emerging economies, have dampened the outlook for trade, particularly in the case of primary commodity exporters. Trade in services continues to grow more strongly than trade in goods, although still at a slower pace than in the pre-crisis years. World commercial services exports in 2013 reached $4.6 trillion,[3] with a growth rate of 5.5 per cent, while according to preliminary joint estimates by the United Nations Conference on Trade and Development and the World Trade Organization, world exports of services grew by 6 per cent in the fourth quarter of 2013, as compared with the same quarter of 2012.

International capital flows

8. As the United States Federal Reserve Bank gradually scales back its monthly asset purchases, developing countries and economies in transition have seen a marked reduction in capital inflows in 2013 and early 2014 and they remain exposed to sudden changes in financial market sentiment. However, the episode in early 2014 differed from the one in mid-2013 in several respects. First, the abrupt change in market sentiment was not triggered exclusively by a shift in views about the Federal Reserve Bank's policy path but by a combination of factors, including fears of a larger-than-expected slowdown in emerging economies. Second, the recent sell-off of emerging market assets was mainly limited to equities, reflecting a flight to safety, with long-term United States interest rates retreating. Third, the most recent market correction was smaller and shorter in duration, with investors discriminating more among emerging economies. Some countries that were among the hardest hit in 2013, such as India and Indonesia, escaped the turmoil in early 2014, following improvement in key macroeconomic indicators. Global financial markets have since calmed and capital flows to emerging economies have stabilized. Capital flows to emerging economies are projected to pick up slowly from the low levels seen in recent quarters, in line with the expected recovery in global growth. However, significant uncertainties and downside risks stem from the interaction between perceptions of the Federal Reserve Bank's tightening path and the idiosyncratic weaknesses in some emerging markets.

[3] World Trade Organization, Press release No. 721, issued on 14 April 2014.

Exchange rates

9. The announcement by the Federal Reserve Bank and activation of quantitative easing tapering have, since mid-2013, led to a large depreciation of many currencies against the United States dollar, although some of the depreciations were a reversal of the appreciation in earlier years. In Western Europe, the fading out of the stimulus from the long-term refinancing operations and the lack of further stimulus measures by the European Central Bank, despite weak economic activity, have led to upward pressure on the currency. From a low of 1.20 in mid-2012, the euro has appreciated significantly against the dollar and is currently just below 1.40. By contrast, the introduction of new qualitative easing measures in Japan during 2013 has triggered a significant depreciation of the yen vis-à-vis all major currencies. In China, the renminbi continued to appreciate gradually against the dollar in 2013, but in the first two months of 2014, the appreciation trend came to an abrupt halt as the exchange rate reversed and experienced the largest depreciation in recent years. This mainly reflects the efforts of the People's Bank of China to alter the market trend of one-way bets on the appreciation of the renminbi. The currencies of many emerging economies depreciated sharply against the dollar in the second half of 2013, but some of them have managed to stabilize in early 2014.

Global imbalances

10. Global imbalances, that is the current account imbalances across major economies, have continued to narrow in the past few years to the lowest level relative to world gross product in a decade and are expected to remain at a benign level in 2014 and 2015. While the United States remained the largest deficit economy, its external deficit is expected to be about 2.2 per cent (of gross domestic product (GDP)) in 2014, down significantly from the peak of 6.0 per cent registered in 2006. On the other hand, the aggregate external surplus of China, Japan and a group of fuel-exporting countries has narrowed accordingly. China, for instance, is expected to register a surplus of just above 2.0 per cent in 2014, a sharp decline from a high of 10.0 per cent in 2007. Japan's surplus is expected to drop to less than 1.0 per cent. In contrast, the surplus of the euro area as a whole has increased to about 2.9 per cent, with Germany running a surplus of 7.0 per cent. Large surpluses relative to GDP are still present in oil-exporting countries, at about 16.0 per cent in Saudi Arabia and at even higher levels in some of the other oil-exporting countries. While some of the adjustment of the imbalances in major economies reflects certain improvements in the unbalanced domestic structure of these economies, other parts of the adjustment reflect a cyclical adjustment: a weakening in external demand from the deficit countries, rather than a strengthening of external demand from the surplus countries.

Economic outlook by regions

Developed economies

11. In the United States, the growth momentum built in the second half of 2013 weakened notably in the first quarter of 2014, mainly because of inclement weather, but growth is expected to pick up going forward. GDP is expected to grow by 2.5 and 3.2 per cent in 2014 and 2015, respectively. Both private consumption and business investment are expected to increase at a stronger pace than in the past two

years, along with a continued improvement in the labour market and the housing sector. Monetary policy is expected to remain highly accommodative during 2014 and into 2015, while fiscal policy will be less restrictive than in 2013. The external conditions for the United States economy are expected to improve, but only slightly, as foreign demand from major trade partners is expected to remain relatively weak.

12. After registering growth of 2.0 per cent in 2013, the Canadian economy is expected to weaken slightly in 2014 with growth of 1.9 per cent but projected to accelerate to 2.8 per cent in 2015. Employment has stalled and household consumption is muted. A drawdown in inventories is also expected to have some negative impact on GDP growth. The cyclical downturn in residential construction is expected to continue in 2014 and the growth of government spending will also be limited. On the positive side, the expected strengthening in the United States economy will provide some support for Canadian exports.

13. The Japanese economy expanded by 1.5 per cent in 2013 and is projected to expand by 1.4 and 0.9 per cent in 2014 and 2015, respectively. The fiscal stimulus package introduced in 2013 supported growth, but this stimulus is set to fade out. In April 2014, with an increase in the sales tax, the Government injected more expenditure through a supplementary budget, but the magnitude is not enough to offset fully the negative impact of higher taxes. Unconventional monetary policy implemented in April 2013 has driven down the yields of long-term securities and guided inflation expectations towards a higher level, as intended. It has also led to a significant depreciation of the Japanese yen vis-à-vis other major currencies, giving a further boost to headline inflation. However, wage growth has been limited and may not provide sufficient support to keep inflation close to the target of 2.0 per cent. The depreciation of the yen has so far had limited effects on boosting exports. Although the recovery in the labour market has been slow, the ageing population has kept the unemployment rate on a slowly declining path.

14. Western Europe emerged from recession in the second quarter of 2013. In the 15 States members of the European Union as at the end of 2003, GDP is expected to grow by 1.5 per cent in 2014 and 1.8 per cent in 2015. Since the announcement by the European Central Bank of its Outright Monetary Transactions facility in August 2012, financial tensions in the region have subsided significantly and confidence has rebounded. Fiscal austerity programmes have lessened in intensity and balance sheet repair, while ongoing, is also less of a drag on activity. The recovery remains weak, with GDP still below its pre-crisis level. The substantial slack in the region, coupled with the slow growth profile, strong currencies and weaker commodity prices, has led to extremely low rates of inflation, to the point of triggering concerns about the risk of deflation. The weakness of the recovery is also a major factor behind the dire unemployment situation. In these 15 countries, unemployment was 11.1 per cent in 2013 and is only expected to stabilize in 2014, before coming down to 10.6 per cent in 2015. This figure masks tremendous disparities across the region, with unemployment expected to be only 5.5 per cent in Germany but 25.9 per cent in Spain.

15. The recovery in the new European Union States members is firming against the backdrop of stronger activity in the 15 States members of the European Union as at the end of 2003, a modest pick-up in domestic demand, less fiscal drag and a turnaround in the inventory cycle. All countries in the region are expected to register positive growth in 2014, with the exception of Croatia. The aggregate GDP of the new member States is expected to grow by 2.4 per cent in 2014 and by 2.9 per cent

in 2015. Households remain burdened by foreign currency-denominated debt and continued deleveraging, but low inflation and strengthening of real wages should boost their spending. Although the economies still operate below full capacity and foreign direct investment remains disappointing, investment should also pick up gradually, benefiting from improved business confidence and absorption of European Union funds. Inflation in many of the new member States remained at historically low levels in early 2014 and should stay in the low single digits. Labour market conditions improved slightly in early 2014, although the situation varies across countries.

Economies in transition

16. The Commonwealth of Independent States (CIS) region continues to face a challenging international environment and, in addition, many countries are confronted with domestic challenges and risks. Several large CIS economies stagnated in early 2014. Growth in the Russian Federation, which has a strong influence over the region, was already disappointing in 2013 and the conflict around Crimea and the possibility of economic sanctions targeting broader sectors of the Russian economy have led to a massive outflow of capital and further weakening of business and consumer confidence. Depreciation of the currency in early 2014 added to inflation, undermining private consumption, and the resulting hike in the policy interest rates will further curb private investment. In 2014, growth in the Russian Federation is expected to be very low, despite fiscal expenditure on a number of infrastructure projects. The economy of Ukraine is expected to shrink in 2014 because of the political crisis, weakness in private consumption, disruptions in trade flows and significant fiscal retrenchment. Low growth is also expected in Belarus, which is strongly exposed to trade with the Russian Federation and Ukraine. By contrast, economic expansion, driven by commodity exports, is expected to continue in Central Asian economies. In Kazakhstan, high fiscal spending to offset the impact of currency devaluation on household consumption and improved competitiveness should sustain the economic momentum. Average inflation in the CIS region is likely to accelerate in 2014. The weaker currencies in Kazakhstan, the Russian Federation and Ukraine will contribute to imported inflation, while inflation in the energy exporters of Central Asia will remain high due to foreign exchange inflows and continuing public spending. For the lower-income CIS economies, such as Armenia, Kyrgyzstan, the Republic of Moldova, Tajikistan and Uzbekistan, the weakening of the Russian currency, as well as the devaluation in Kazakhstan, may adversely impact the value of remittances sent home by migrant workers, restraining private consumption and, possibly, growth. The prospective establishment of the Eurasian Economic Union in 2015 should contribute to stronger intraregional economic ties. The aggregate GDP growth in the CIS region and Georgia is expected to decelerate from 2.0 per cent in 2013 to 1.6 per cent in 2014, strengthening only modestly to 2.3 per cent in 2015.

17. The aggregate GDP of South-Eastern Europe increased by 1.9 per cent in 2013. Although still subject to numerous risks, growth is projected to accelerate to 2.0 per cent in 2014 and to 3.1 per cent in 2015, along with recovering FDI flows and strengthening domestic demand. Acceleration of growth to around 3.0 per cent would be a welcome development, but this still would be below pre-crisis growth levels and insufficient to address the region's structural needs of reindustrialization, higher labour participation ratios and a reduction of high unemployment rates,

especially among youth. The region remains dependent on external financing to cover large current account deficits and faces repayments of private debt and loans taken from multilateral institutions. Obtaining access to external funding may pose challenges against the backdrop of cooling investor sentiment towards emerging markets.

Developing economies

18. Africa will continue to see solid growth of 4.2 per cent this year, although political problems in a number of countries have led to a downward revision compared to the previous forecast. In Libya, for example, disruptions to oil output and exports will be a major drag on growth, underpinning a significantly lower growth rate for North Africa than previously forecast. A more pronounced increase in growth will occur in Central Africa, although this is largely due to negative base effects from 2013 and masks a continuing precarious political situation in the Central African Republic. In 2015, overall growth will accelerate to 5.1 per cent, carried by some rebound in North Africa in view of a recovery of oil exports in Libya and stronger growth in South Africa underpinned by solid export demand and increasing consumption and investment. Aggregate inflation will continue to decrease from 6.9 per cent in 2014 to 6.5 per cent in 2015 due to steady or lower commodity prices. However, in various commodity-exporting economies, these price trends have also contributed to currency depreciation, offsetting some of the decrease in inflation. On the fiscal side, these commodity price changes will exert pressure on fiscal revenues in the commodity-exporting economies, while fluctuations in external budgetary support hamper growth in some countries. Monetary policy has been tightened in a number of African economies, a trend that will continue into 2015 because of high inflation in countries such as Nigeria or depreciating currencies in a number of others. The lower expected growth trajectory will compound some severe labour market problems, such as high unemployment rates, widespread underemployment, low earnings and gender disparities in earnings and employment opportunities. Export growth is expected to rise after slower growth in 2012 and 2013, while import growth will continue to remain strong, propelled by large infrastructure projects.

19. East Asia is expected to see robust growth as exports to developed countries strengthen and domestic demand in most economies remains firm. Economic activity in the region is projected to expand by 6.0 per cent in both 2014 and 2015, the same pace as in 2013 and a marginal downward revision from the previous forecast. China's growth rate is expected to moderate further over the next few years, with GDP projected to expand by 7.3 per cent in 2014 and 7.1 per cent in 2015, down from 7.7 per cent in 2013. This lower growth trajectory is in line with the Government's focus on raising the quality of development and economic restructuring. Thailand is the only country in the region for which the short-term outlook has deteriorated sharply since the release of *World Economic Situation and Prospects 2014*. With the continuing political unrest taking an increasing toll on domestic demand, Thailand's GDP growth is projected to drop to about 2 per cent in 2014. The slowdown in China and Thailand will likely be offset by a pick-up in growth in the region's most export-oriented economies, which benefit significantly from stronger demand in the United States and the European Union. In most East Asian economies, household consumption and fixed investment are expected to grow at a steady pace in 2014 and 2015, helped by generally mild inflation, stable

labour markets and accommodative monetary policies. Governments are expected to maintain their current prudent fiscal policy stances. Against the backdrop of improved global conditions, higher interest rates in the United States and a slight acceleration in domestic inflation, central banks may start tightening monetary policy in the latter part of the forecast period.

20. Average economic growth in South Asia is projected to pick up gradually in the forecast period, after remaining at a near two-decade low in 2013. GDP is estimated to expand by 4.6 per cent in 2014 and 5.1 per cent in 2015, up from 3.9 per cent in 2013. The moderate recovery is expected to be underpinned by stronger consumption and investment in the context of enhanced macroeconomic stability. Several of the region's economies, including India, have seen lower inflation, stronger external balances and more stable currencies in recent quarters, conditions that are expected to support business and consumer confidence. External demand is also projected to improve in 2014 and 2015 as economic activity in developed economies gains momentum. The strength of the recovery in South Asia will, however, be restricted by structural impediments, including energy and transport constraints, political unrest and violence, and a lack of economic policy reforms. India's economy is forecast to grow by 5 per cent in 2014 and 5.5 per cent in 2015, only slightly up from 4.8 per cent in 2013. The Islamic Republic of Iran is projected to see a return to mildly positive growth in 2014 as the partial lifting of sanctions helps non-oil exports. Economic growth is also expected to pick up slightly in Bangladesh and Pakistan, supported by increases in remittance inflows and a slowly improving investment climate. Sri Lanka remains the region's fastest growing economy, with annual growth forecast to stay above 7 per cent in the outlook period. A slowdown in inflation in recent quarters has reduced the pressure on central banks to further tighten monetary conditions. At the same time, fiscal balances have slightly improved but deficits are still large and a more sustained consolidation requires significant policy changes on the expenditure and the revenue side.

21. In Western Asia, internal instabilities and lower oil exports continue to shape the economic outlook. Economic activity is still relatively weak in comparison with pre-crisis trends, with growth forecast to reach 3.6 per cent in 2014 after a 3.8 per cent gain in 2013, before accelerating to 4.4 per cent in 2015. The member States of the Gulf Cooperation Council have been on a stable growth path, despite weak oil prices and exports. During the forecast period, economic activity will continue to be supported by expansionary fiscal policies. The economies of Iraq, Jordan, Lebanon, the Syrian Arab Republic and Yemen have been hampered by continuing political instability, social unrest, security incidents and geopolitical tensions. The war in the Syrian Arab Republic has been taking a particularly heavy human toll and has led to the widespread destruction of crucial infrastructure. An extraordinarily large number of refugees have fled to neighbouring countries, posing a severe challenge for public policy and fiscal budgets. In Turkey, the surge in capital outflows and the depreciation of the exchange rate led to sharp increases in policy interest rates at the beginning of 2014. Thus, after accelerating to 4 per cent in 2013, GDP growth is expected to slow down to 2.2 per cent in 2014, before bouncing back in 2015, aided by a pickup in exports. The Israeli economy is expected to remain relatively stable with a moderate improvement throughout the forecast period, as growth will pick up more broadly, helped by strong consumer spending and external demand. Inflation in the region will continue to be relatively stable. One exception is the Syrian Arab

Republic, where inflation is expected to remain extremely high. Geopolitical tensions can further affect the region's economic prospects.

22. Economic growth in Latin America and the Caribbean is expected to continue at a subdued pace in 2014, amid increasing difficulties in some of the largest economies. The region is expected to grow moderately by 2.6 per cent in 2014, although with significant heterogeneity across subregions. Economic growth in Mexico and Central America is strengthening, benefiting from the pickup in activity in the United States, with Mexico expecting to grow by 3.2 per cent in 2014, accelerating from growth of 1.1 per cent in 2013. By contrast, growth in South America is decelerating markedly, from 3.2 per cent in 2013 to 2.1 per cent in 2014. Argentina is experiencing a noticeable slowdown amid decreasing business confidence and persistent inflation pressures, while the Bolivarian Republic of Venezuela is likely to enter into recession. Brazil's economy continues to expand at a very moderate rate of 1.7 per cent in 2014, with meagre prospects for investment demand and increasing pressure for fiscal consolidation. Other South American countries, such as the Plurinational State of Bolivia, Colombia and Peru, continue on a more solid growth path. Meanwhile, growth in the Caribbean is expected to accelerate to 3.6 per cent in 2014. Despite the continuing subdued growth, the unemployment rate is expected to remain relatively low. The outlook for inflation is also fairly stable and low, with the noticeable exceptions of Argentina and the Bolivarian Republic of Venezuela. In adjusting to the domestic business cycle and the United States Federal Reserve Bank's quantitative easing tapering, the monetary stance remains mixed. Some countries with relatively low inflation, such as Chile, Mexico and Peru, have opted to reduce interest rates, while Brazil and others have tightened their monetary stance. Meanwhile, fiscal policy is moving towards a more supportive stance. However, more importantly, reforms are needed in the region to boost investment and productivity growth.

23. The least developed countries will see solid and accelerating growth in 2014 and 2015, benefiting from favourable external demand conditions. In 2014, the least developed countries are expected to expand by 5.6 per cent, a further increase from the rate of 4.8 per cent and 5.3 per cent achieved in 2012 and 2013, respectively. More than one half of these countries are forecast to expand by at least 5 per cent in 2014 and several have registered robust headline growth rates since 2012 (7.0 per cent or more on average), including Sierra Leone, the Democratic Republic of the Congo, Liberia, Ethiopia, Mozambique and Zambia. Aggregate inflation has been declining since 2012 and is expected to reach a historic low of 7.5 per cent in 2015 on the back of generally lower prices for food and energy. However, the outlook for inflation remains heterogeneous across countries. Eritrea, Malawi and the Sudan will register double-digit inflation rates in 2014 and 2015 because of a combination of factors, including food shortages, large fiscal spending, depreciation of domestic currencies and political uncertainty. Despite the strengthening economic conditions, the development prospects in the least developed countries remain severely constrained by many structural factors, such as recurring political conflicts, high vulnerability to adverse weather patterns and commodity price fluctuations, lack of productive diversification and fragile institutions. For instance, in the Central African Republic, the political situation will continue to depress economic development. In Equatorial Guinea, which is heavily dependent on its oil sector, declining oil production will underpin an economic contraction in both 2014 and 2015; this will further cripple the prospects for any meaningful reduction in the high

poverty level that persists despite the country's high per capita income level. In Yemen, despite higher GDP growth in 2013 mainly due to foreign aid, oil and agricultural output has been restricted by internal violence and infrastructure weaknesses. Addressing these structural issues poses a major challenge for the least developed countries. This is compounded further by the recent downward trend in official development assistance (ODA), given the major role it plays in the fiscal budgets of numerous such countries. In this context, the least developed countries also face the need to build and enhance their institutional capacities, which constitutes a precondition for the effective implementation of policies supported by international aid and the provision of public goods and services.

Risks and uncertainties

Unwinding of monetary easing in major developed countries

24. An important risk factor for global growth and financial stability remains the future adjustment in monetary policies by major developed countries, particularly quantitative easing. Since its introduction after the eruption of the global financial crisis, quantitative easing has already created numerous forms of spillover in the global economy.[4] For example, in previous years, lower interest rates in developed countries underpinned capital flows to higher-yield markets, especially in emerging economies, accompanied by upward pressure on exchange rates and pressure on the competitiveness of exports. Most recently, the prospect of an exit from quantitative easing in the United States and higher interest rates has led to capital outflows and a sharp depreciation of currencies in developing countries, as evidenced in mid-2013 and early 2014.

25. The expected phasing out of quantitative easing in the United States in late 2014 and an expected increase in policy interest rates in mid-2015 could lead to overshooting in long-term interest rates worldwide, selling off in global equity markets, outflows of capital from emerging economies, an increase in external financing costs for developing countries and further depreciation of currencies for emerging economies. As a result, developing countries and economies in transition could face more painful adjustments and the moderate global growth could be derailed.

Vulnerability in emerging market economies

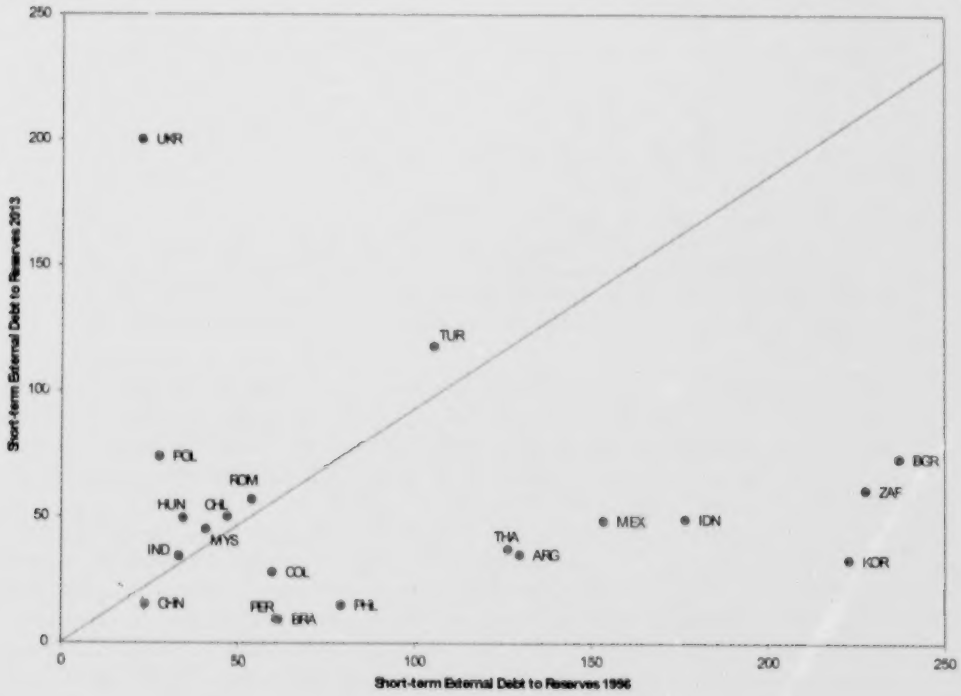
26. The recent episodes of financial market turmoil in emerging markets have raised fears that these economies could be hit particularly hard by an upcoming monetary tightening cycle in major developed economies. The sudden massive capital outflows from emerging markets seen in mid-2013 and again in January 2014, which caused asset prices and currencies to tumble, have brought back memories of the emerging market crises of the 1990s, most notably Mexico's economic crisis in 1994 and the Asian financial crisis of 1997/98. However, as illustrated in *World Economic Situation and Prospects 2014*, emerging market economies as a whole seem to be in a much better position at the present time to weather tighter liquidity conditions and capital outflows. A key weakness in the

[4] See also *World Economic Situation and Prospects 2014* (United Nations publication, Sales No. E.14.II.C.2), box I.3.

1990s was the combination of overvalued fixed exchange rates and large-scale foreign currency borrowing. By contrast, most emerging economies now operate more flexible (though still managed) currency regimes and foreign currency borrowing has generally been more limited. More flexible exchange rate regimes have supported the necessary rebalancing process. A case in point is India, where the rupee's fall in 2013 has played an important role in reducing the current account deficit. Importantly, the ratio of short-term external debt to international reserves is also much lower today than it was in the mid-1990s, especially in East Asian and Latin American countries (see fig. 1). In addition, macroeconomic policy management has improved over the past 20 years: financial sector supervision and regulation have been strengthened, macroprudential oversight has been enhanced and monetary and fiscal policies have become more prudent. Consequently, a widespread severe emerging market crisis triggered by a sudden reversal of capital inflows seems unlikely at present. This is also reflected in the relatively low bond spreads that are currently observed in most emerging markets (see fig. 2).

Figure 1

Short-term external debt to total reserves 1996 compared to 2013 (percentage)[a]



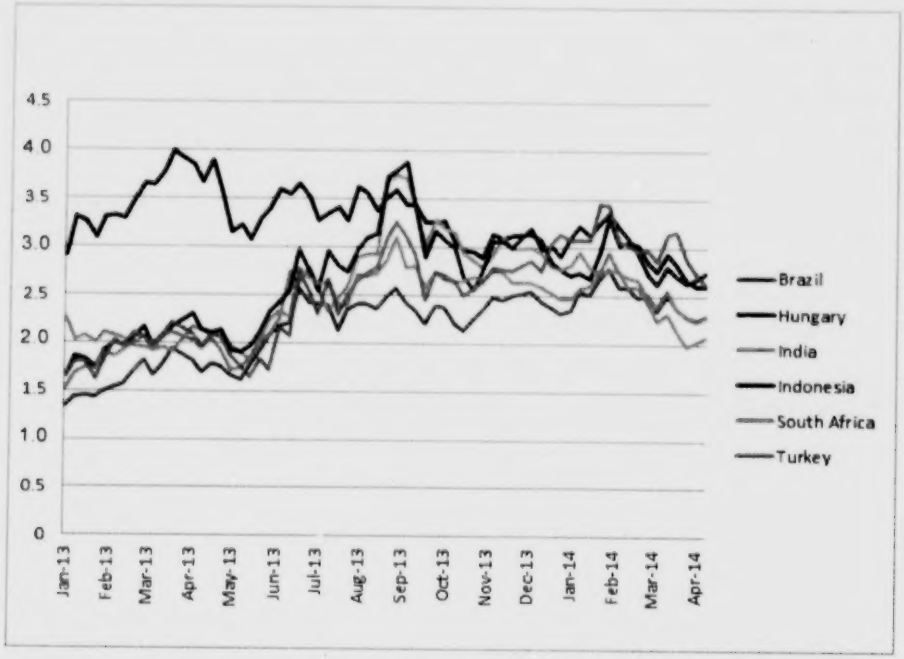
Sources: Short-term external debt data are taken from World Development Indicators database and Quarterly External Debt database, jointly developed by the World Bank and the International Monetary Fund (IMF); debt data for Chile and the Republic of Korea are taken from national central banks. Foreign exchange reserves (excluding gold) are taken from IMF International Financial Statistics.

Note: For South Africa, the earlier figure is for 1997; for Argentina, the later figure is for 2012.

[a] Indicated by the three letter-codes assigned by the International Organization for Standardization.

Figure 2

EMBI Global[a] strip spreads in selected economies (weekly; percentage points), January 2013-April 2014



[a] The JP Morgan Emerging Markets Bond Index Global (EMBI Global) measures the total returns for United States dollar-denominated sovereign debt instruments. The sovereign spread is calculated over the entire duration of the strip Treasury curve using zero coupon rates. The spread is quoted in basis points. Higher values indicate higher default risk.

27. Yet, there are weaknesses and potential vulnerabilities at the individual country level. On the external front, the ratio of total external debt to GDP has increased in the majority of emerging economies since the global financial crisis but remains at low to moderate levels except in some Eastern European countries (e.g., Hungary). Current account deficits (relative to GDP) are, however, still large in a number of countries, such as Turkey, Ukraine and South Africa. These countries appear to be most vulnerable to further capital reversals, especially when short-term external debt levels are also elevated. Further monetary policy tightening and substantial increases in financing costs in some emerging economies in response to external financial pressures could further hamper growth. A combination of slowing growth and higher interest rates can significantly heighten the risks for banks and non-bank financial institutions in many emerging economies as the volume of credit available to the private sector has increased rapidly in recent years to elevated levels. Meanwhile, political instability and weak economic policy credibility are additional risks for several emerging economies.

Remaining fragilities in the euro area

28. In the euro area, the systemic risks have subsided dramatically since the European Central Bank announced its Outright Monetary Transactions facility in August 2012. Despite having never been deployed, its mere existence has broken the negative feedback loop between weak banks and weak government fiscal positions. Sovereign bond spreads have narrowed significantly since its announcement and the sense of crisis has dissipated despite occasional events, both economic and political, that in the past would have led to renewed crisis.

29. Nonetheless, significant fragilities remain. The banking sector remains under stress. Lending conditions remain heterogeneous across the region with overall credit to the private sector still declining. In addition, the European Central Bank and the European Banking Authority are currently performing a major asset quality review and stress tests for a large sample of the region's banks. These are expected to determine a need for significant recapitalization of some banks, with a question of who will pay for it. If governments were to be required to finance a large portion of this recapitalization, the negative feedback loop could re-emerge.

30. With extremely high unemployment rates in some countries, inflation remains dangerously low. In the euro area, it has been below 1.0 per cent since October 2013, which, in conjunction with continuing weak growth in output, raises the spectre of Japanese style deflation. Aside from being exceptionally difficult to exit, deflation would also increase real government debt burdens and perhaps reignite the debt crisis as fiscal targets become increasingly difficult to achieve.

Other uncertainties and risks

31. There are other risks and uncertainties for the world economies. Public finances in many developed countries are still not on a sustainable path in the longer term. For example, in Japan, with its debt at 220 per cent of GDP, one half of the revenue from new debt issuance was spent on debt servicing in recent years. The increase of the sales tax rate in 2014 is not sufficient to balance the primary budget. One potential risk is that financial markets demand a higher return. This risk will become even more acute if the current account turns into a deficit for a sustained period.

32. In addition, geopolitical tensions in many parts of the world, extreme climates and environmental disasters all pose consequential risks for the world economy.

Policy challenges

Fiscal policy stance

33. The size of the average budget deficit in developed countries fell to 4.9 per cent of GDP in 2013 from 6.2 per cent in 2012, but public debt continued to rise. In the outlook, fiscal tightening will likely continue in most of the developed economies in 2014 but at a slower pace. In the United States, following the fiscal austerity of past years, the fiscal drag on growth should be less contractionary in 2014. In the European Union, the speed of fiscal consolidation has varied across countries, although the most indebted countries have already implemented drastic austerity packages. In Japan, where a large fiscal stimulus package was adopted in early 2013, the budget deficit increased to around 10.0 per cent of GDP. A

supplementary package was introduced at the end of 2013 to soften the impact of the higher sales tax rate.

34. In many developing countries and economies in transition, the fiscal position of which in terms of budget deficits and public debt was generally better than that of developed economies, budget deficits measurably increased in 2013, especially in a number of low-income countries. Reasons include increased public spending or lagging revenues, caused by weaker commodity prices. Although in general public debt levels in developing countries are relatively low, increasingly volatile terms of access to financial markets and the rising share of external debt may create challenges in debt refinancing. At the same time, many developing economies are confronting poverty and increasing inequality, requiring a mix of fiscal prudence and a sustainable framework of social security for reducing poverty and inequality.

Monetary policy stance

35. Monetary policies in major developed countries remain accommodative, featuring policy interest rates at or near zero and quantitative easing. In addition, central banks in these countries adopt forward guidance as an important tool for reducing the potential for surprise and managing market expectations. Among the challenges is the formulation and timing of changes in forward guidance. For example, in early 2014, the United States Federal Reserve Bank changed the wording of its forward guidance, driven especially by the faster than expected fall in unemployment, which was largely due to a lower labour participation rate. In terms of differences across countries, while the Federal Reserve Bank is struggling with charting its exit from its current policy stance, the European Central Bank hinted at the possibility of taking an even more accommodative stance through new quantitative easing measures or via another cut in policy rates which would introduce a negative deposit rate.

36. Monetary policies vary in the developing countries and economies in transition, with some countries taking a tightening stance while others are easing. The relevant determinants include spillovers from policy tightening in developed countries, especially in the form of capital inflow reversals and exchange rate depreciation; inflation rates, which remain high in numerous developing countries; unemployment levels; and overall economic growth. In this context, policymakers in several emerging markets have already had to confront the dilemma of slowing growth, which would merit lower policy interest rates, and the need to cope with external conditions through higher interest rates.

Policy challenges for managing the unwinding of quantitative easing

37. The withdrawal and unwinding of quantitative easing measures constitute a major policy challenge in terms of the precise design and timing of individual actions. At the operational level, policymakers need to determine the magnitude and schedule of the reduction in asset purchases, decide on whether and at what pace to reduce their asset holdings, and tie this in with the future path of policy interest rates. These policy decisions continuously have to be reassessed and reflected against the emerging macroeconomic data outlook and the state of the real economy.

38. To reduce the risks for global growth and financial stability, policymakers should pursue a clear communication strategy that provides concise guidance and effectively manages market expectations. In addition, policies explicitly need to take

into account the risk of a premature withdrawal in the form of a more pronounced weakening of the economic recovery, as well as the possibility that a delayed unwinding could drive up asset prices to unsustainable levels. For the case that financial markets overreact and contagion takes hold across the financial system, contingency plans need to be developed with broad coordination at the international level. Moreover, enhanced supervision, regulation and surveillance can help to reduce risks and vulnerabilities by addressing emerging problems at an early stage. In developing countries, the challenge lies in dealing with the possible spillovers from the unwinding of quantitative easing in developed countries. This applies especially to those countries that are highly exposed to international capital markets and run large external imbalances financed by short-term external capital flows.

Policy challenges for strengthening employment

39. As the number of jobs lost in comparison with the pre-crisis employment trend continues to increase and structural unemployment remains a major problem, policymakers will need to implement more supportive macroeconomic policies and active labour market policies. Macroeconomic policies have so far been uncoordinated and their impact on job creation limited. While expansionary monetary policies in developed economies have helped in avoiding larger falls in employment, they have not sufficiently stimulated employment. Moreover, weak aggregate demand, combined with fiscal consolidation in many developed economies and, more recently, in some emerging economies, has led to a slow economic recovery and high uncertainty regarding the economic outlook. This in turn has limited the willingness of the private sector to invest. Hence, as emphasized by finance ministers and central bank governors at the most recent meeting of the Group of 20, fiscal strategies will need to be more supportive of output growth and employment creation. In addition, on the monetary side, access to credit for small and medium-sized enterprises is essential as they play a significant role in job creation. Ultimately, there is the need to adequately coordinate monetary and fiscal policies in order to foster employment creation.

40. In terms of concrete labour market policies, policymakers will need to minimize individual losses due to reallocation of labour across sectors and to facilitate the re-employment of those that have experienced long spells of inactivity. First, governments will need to find the right balance between recent labour market flexibility initiatives, which are expected to create more dynamic labour markets, and unemployment benefit schemes in order to minimize individual losses for those who face higher risks of long-term unemployment and poverty. Second, unemployment benefits should be coupled with active labour market policies. Long-term unemployment, which has been on the rise, leads to depreciation of human capital, negative health effects and higher risks of aggravating structural unemployment. Specific lessons learned from the Organization for Economic Cooperation and Development (OECD) countries with lower unemployment rates during the crisis indicate that activation strategies for unemployed individuals should include job search assistance and training programmes, as well as institutional reforms to better coordinate unemployment schemes with employment services. However, the main challenge remains that many governments have limited resources to ensure such adequate employment services. In many developing countries, greater diversification and the development of higher value-added sectors

through more proactive industrial and innovation policies are needed to reduce unemployment and underemployment and to increase formal employment.

Development in international trade policies

41. Intensive efforts are under way within the World Trade Organization on implementing the outcomes of the Bali Ministerial Conference held in December 2013 and refocusing new efforts to complete the Doha Round. The extent of progress should become clearer later in 2014.

42. In regard to regional trade agreements, little progress has been made with respect to two major agreements, the Transatlantic Trade and Investment Pact and the Trans-Pacific Partnership. A controversial point has been the inclusion of investor-state dispute settlement agreements in the Pact. Some consider that such dispute settlement is necessary to ensure that companies operating in foreign countries are not subject to discriminatory regulations, whereas others are of the view that it will give companies undue influence over the ability of governments to regulate industries within their borders. However, progress has occurred in regard to bilateral trade agreements. Japan and Australia signed a free trade agreement which allows significantly greater food imports into Japan, and reduces tariffs on cars, auto components and electronics, among other goods imported by Australia. Panama and Mexico also signed a free trade agreement which is a prerequisite for Panama joining the alliance comprised of Mexico, Chile, Colombia and Peru.

International policy coordination

43. The need for more effective international policy coordination has become an imperative against the backdrop of a fragile recovery of the global economy and various downside risks, such as destabilizing capital outflows and exchange rate volatility in emerging markets. In particular, stimulating global demand and output growth should remain an overarching priority for enhanced policy coordination at the global level.

44. Finance ministers of the Group of 20, meeting in early 2014, committed to raising their collective GDP by more than 2 per cent, or by US $2 trillion in five years, to reduce their output gaps. They agreed to develop a comprehensive growth strategy, the Brisbane Action Plan, ahead of the convening of the Group of 20 Summit later in 2014.

45. Moreover, efforts are needed in relation to international tax cooperation. Profits should be taxed where they are earned and all countries should sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in order to enhance compliance with domestic tax regulations. Further progress is needed to fight cross-border tax evasion and tax avoidance.

46. In the area of international financial regulation, some progress has been made in recent months, with large banks on course to meet the new Basel III capital requirements almost five years ahead of the deadline. The Financial Stability Board agreed on a globally consistent leverage ratio, which financial institutions will be required to disclose by January 2015. In its efforts to end the so-called "too big to fail" problem, the Board has already identified systematically important banks and is developing a global standard for the minimum loss absorption capacity that these banks should maintain in order to mitigate the risk of default. Such financial

reforms need to be implemented promptly and consistently, and international regulatory cooperation needs to be strengthened.

47. Priorities should also be given to the implementation of the IMF quota and governance reforms agreed to in 2010.

48. Regarding international development cooperation policies, ODA flows have rebounded by 6.0 per cent in 2013 from the decline in 2011 and 2012, reaching a record level, but are still far below the United Nations target of 0.7 per cent of gross national income. Development partners should ensure that sufficient external resources are available to developing countries, particularly to the least developed countries, to strengthen their capacity to meet the Millennium Development Goals and to implement the post-2015 development framework.